Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author: Davis | Analyst: Garnier | Bill Number: AB 430

Related Bills: See Leg. History | Telephone: 845-5322 | Introduced Date: 02/12/99

Attorney: Doug Bramhall | Sponsor:

SUBJECT: Health Insurance Deduction/Self-Employed Individuals/100% of Amount Paid

SUMMARY

Under the Personal Income Tax Law (PITL), this bill would allow self-employed individuals to deduct from gross income up to 100% of the cost of health insurance. The deduction would be phased in from 45% in 1999 to 100% in 2007.

EFFECTIVE DATE

As a tax levy, this bill would be effective upon enactment and operative for taxable years beginning on or after January 1, 1999.

LEGISLATIVE HISTORY

AB 130 (1999), SB 305, SB 1991, AB 2107, AB 2131 (1997/98)

SPECIFIC FINDINGS

Existing federal law provides for a deduction in determining adjusted gross income (AGI) of 60% (effective for 1999) of a self-employed individual's cost for health insurance. Federal law also allows the deductible percentage to increase incrementally to 100% beginning in the year 2003. The percentage is increased as follows:

1999 through 2001	60%
2002	70%
2003 and thereafter	100%

Prior to the enactment of the **federal Tax and Trade Relief Extension Act of 1998,** (TTREA) the federal deductible percentage incrementally increased from 45% in 1998 to 100% in 2007.

California law provides for 40% of the cost of a self-employed individual's cost for health insurance to be deductible in determining AGI.

Under both federal and state law, "health insurance costs" include premiums paid for health insurance of the taxpayer, taxpayer's spouse and dependents. Certain qualified "long term care premiums" are also considered health insurance.

Additionally, **under both** federal and state law, a deduction for health insurance for self-employed individuals is not allowed from gross income if the individual or individual's spouse is eligible to participate in any subsidized health plan of any employer of the individual or individual's spouse.

Board Position:

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Department Director: **Gerald Goldberg** Date: **3/24/1999**

The deduction from gross income is limited to the extent of the individual's federal earned income from the business from which the health coverage was established.

Finally, **under both** federal and state law, the cost of health insurance incurred by a self-employed individual that is not deductible in determining AGI may be taken as an itemized medical deduction. Itemized medical deductions are limited to the amount that exceeds 7.5% of the taxpayer's AGI. All individuals may deduct health insurance costs paid by the individual, which are not excluded from income, as an itemized medical deduction subject to the 7.5% AGI floor.

This bill would increase the percentage of health insurance deductible by self-employed individuals from the 1999 level of 40% to 100% in 2007, as follows:

45% in 1999,
50% in 2000 and 2001,
60% in 2002,
80% in 2003 through 2005,
90% in 2006, and
100% in 2007 and thereafter.

These phase-in amounts follow the federal phase-in amounts prior to changes made to those federal rules by TTREA in 1998. The author's staff has indicated that the bill will be amended to increase the California deductible percentage to 60% beginning in 1999 and thereafter.

FISCAL IMPACT

Departmental Costs

The provisions of the bill would not significantly impact the department's costs.

Tax Revenue Estimate

The revenue losses from this provision are estimated to be as shown in the following table.

Fiscal Year Cash Flow Impact Effective 1/1/99 Enactment Assumed After June 30, 1999 $ Millions							
1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
($7)	($9)	($14)	($32)	($56)	($63)	($78)	($109)

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion:

The revenue impact of this provision will be determined by the number of self-employed individuals who claim additional insurance deductions and the average marginal tax rate applicable to the deduction amounts.

This estimate was developed in the following steps. First, the number of California resident taxpayers who currently claim the self-employed insurance deduction was calculated from returns filed for 1995 (425,000). Second, the 25% deduction amount for that year was calculated to be $839 on average for returns filed in 1995, making the average annual health insurance premium $3,356 ($839 x 4). Third, the estimated number of qualified taxpayers for 1995 was grown at 5% per year to yield 517,000 qualified taxpayers for 1999. Fourth, the insurance premium was grown at 7% per year to yield an average $4,399 insurance premium for 1999. Fifth, the total deduction at 40% was calculated to be $910 million for 1999, and the amount deducted for health insurance premiums on Schedule-A was calculated to be $326 million, generating a total deduction amount under current law of $1,236 million. At an average marginal tax rate of 4.5% (computed by the PIT microsimulation model for self-employed individuals), the current law revenue loss for 1999 is $56 million. Sixth, the total deduction was calculated at 45% at a 4.5% marginal tax rate for 1999, generating a $46 million tax loss, and the loss for health insurance premiums on Schedule-A was calculated to be $14 million, generating a total $60 million tax loss. These steps resulted in a 1999 liability year estimate of an additional $4 million tax loss. The losses computed for fiscal years after 1999/2000 were fiscalized and grown to reflect a combined annual growth of 5% (qualified taxpayers) and 7% (premiums) based on current historical averages.

BOARD POSITION

Pending.